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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In The Matter Of: An Investigation Pursuant to KRS 278.260 of the Earnings Sharing Mechanism Tariff of Kentucky Utilities Company — Case No. 2003-00334

In The Matter Of: An Investigation Pursuant to KRS 278.260 of the Earnings Sharing Mechanism Tariff of Louisville Gas and Electric Company — Case No. 2003-00335

RESPONSE TO THE FIRST DATA REQUEST OF KENTUCKY PUBLIC SERVICE COMMISSION STAFF TO BARRINGTON-WELLESLEY GROUP, INC.

FILED: October 20, 2003

Barrington-Wellesley Group, Inc.
Management Consultants
2479 Lanam Ridge Road • Nashville, IN 47448 • Tel: (812) 988-0190 • Fax (812) 988-0194

October 20, 2003

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PUBLIC SERVICE COMMISSION

Mr. Thomas Dorman, Executive Director
Kentucky Public Service Commission
P.O. Box 615
211 Sower Boulevard
Frankfort, Kentucky 40601

RE: ***AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF KENTUCKY UTILITIES COMPANY***
CASE NO. 2003-0334

and

AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF LOUISVILLE GAS AND ELECTRIC COMPANY
CASE NO. 2003-0335

Dear Mr. Dorman,

Please find enclosed one original and four copies of Barrington-Wellesley Group, Inc.'s (BWG) response to the October 6, 2003, First Data Request of Commission Staff to Barrington-Wellesley Group, Inc.

Please contact me if you have any questions concerning this filing.

Sincerely,

Michael A. Laros

Michael A. Laros
Managing Director

Enclosures

cc: Hon. Elizabeth E. Blackford, Assistant Attorney General
Hon. Michael L. Kurtz, Boehm, Kurtz & Lowry
Hon. Kendrick R. Riggs, Ogden, Newell & Welch, PLLC
Hon. Linda S. Portasik, LG&E Energy Corp.
Mr. Michael S. Beer, LG&E Energy Corp
Mr. John Wolfram, LG&E Energy Corp.

KPSC
Staff DR.

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PUBLIC SERVICE
COMMISSION

Paul E. Patton, Governor

Janie A. Miller, Secretary
Public Protection and
Regulation Cabinet

Thomas M. Dorman
Executive Director
Public Service Commission

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
211 SOWER BOULEVARD
POST OFFICE BOX 615
FRANKFORT, KENTUCKY 40602-0615
www.psc.state.ky.us
(502) 564-3940
Fax (502) 564-3460

Martin J. Huelsmann
Chairman

Gary W. Gillis
Vice Chairman

Robert E. Spurlin
Commissioner

October 6, 2003

Michael A. Laros
Managing Director/Co-President
Barrington-Wellesley Group, Inc.
2479 Lanam Ridge Road
Nashville, IN 47448

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PUBLIC SERVICE
COMMISSION

RE: Case No. 2003-00334

Please see enclosed data request from Commission Staff in the above case.

If you need further assistance, please contact Richard Raff at (502) 564-3940 ext. 260.

Sincerely,

Thomas M. Dorman
Executive Director

TD/jc
Enclosure

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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF KENTUCKY UTILITIES COMPANY	)	CASE NO. 2003-00334
AND		
AN INVESTIGATION PURSUANT TO KRS 278.260 OF THE EARNINGS SHARING MECHANISM TARIFF OF LOUISVILLE GAS AND ELECTRIC COMPANY	)	CASE NO. 2003-00335

FIRST DATA REQUEST OF COMMISSION STAFF
TO BARRINGTON-WELLESLEY GROUP, INC.

The Barrington-Wellesley Group, Inc. ("BWG"), pursuant to 807 KAR 5:001, is requested to file with the Commission the original and 8 copies of the following information, with a copy to all parties of record. The information requested herein is due on or before October 20, 2003. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the person who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible. Where information herein has been previously provided, in the format requested herein, reference may be made to the specific location of said information in responding to this information request.

1. Refer to BWG's "Final Report on the Focused Management Audit of Louisville Gas and Electric's and Kentucky Utilities' Earning Sharing Mechanism" ("BWG Report"), page III-6. Using company job titles, distinguish between middle management, executive management, junior executives, and senior executives at Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU").

2. Refer to the BWG Report, page III-7, the discussion concerning income tax liabilities.

a. Indicate how many years of income tax calculations were reviewed by BWG and state how the number of years to be reviewed was determined.

b. For each year the income tax liability calculations were reviewed, provide the calculated tax liabilities collected from LG&E and KU and the corresponding consolidated tax liability for LG&E Energy Corp. ("LEC") and its parent.

3. Refer to the BWG Report, page III-10, Recommendation No. 1. Explain in detail how naming a single executive as responsible for the integrity of the Kentucky regulated utilities would address the problem identified by BWG, when it is likely the employees below and the management above this individual would have both regulated and non-regulated responsibilities.

4. Refer to the BWG Report, page IV-5. The BWG Report states that the incentive payments in 2002 were at 100 percent or more and that the Short-Term and TIA payouts would have been lower without the merger-guaranteed floor. Indicate what the incentive payouts for the Short-Term and TIA would have been without the merger-guaranteed floor.

5. Refer to the BWG Report, page IV-6, Recommendation No. 1. BWG has recommended that the incentive payments should be reduced if the allowed rate of return is not achieved.

a. In stating that a reduction should occur if the allowed rate of return is not achieved, does BWG mean the 11.5 percent rate of return on equity or anywhere within the deadband? Explain the response.

b. Based on BWG's experience, is this the normal "penalty" assessed for failing to meet target performance? Explain the response.

6. Refer to the BWG Report, page V-8, Recommendation No. 1. Explain in detail how the implementation of a multi-year Earnings Sharing Mechanism ("ESM") based on the current ESM format would resolve the concern that the utilities may be encouraged to shift costs between accounting periods in order to invoke an ESM factor revenue adjustment.

7. Refer to the BWG Report, page VIII-3. BWG states, "The primary influence on cost structure has been implementation of the Value Delivery Team initiative, approved by the Commission in 2000." Provide citations to and quotations from the applicable Orders where the Commission approved the Value Delivery Team initiative in 2000.

Thomas M. Dorman
Executive Director
Public Service Commission
P. O. Box 615
Frankfort, Kentucky 40602-0615

DATED: October 6, 2003

cc: All Parties

BARRINGTON-WELLESLEY GROUP, INC.

CASE NOS. 2003-00334 & 2003-00335

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PUBLIC SERVICE COMMISSION

Response to First Data Request of Commission Staff
Dated October 6, 2003

Question No. 1

Responding Witness: David P. Vondle

Q-1. Refer to BWG's "Final Report on the Focused Management Audit of Louisville Gas and Electric's and Kentucky Utilities' Earning Sharing Mechanism" ("BWG Report"), page III-6. Using company job titles, distinguish between middle management, executive management, junior executives, and senior executives at Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU").

A-1. Individual interpretations of the terms, "executive management, middle management, et al," may vary. In general, executive management for LG&E and KU is provided by the Services Company. Executives, senior managers and workers who serve both regulated companies are employees of the Service Company. The only actual employees of LG&E and KU are individuals who work virtually exclusively for one or the other and are normally physically located in the Companies' territories. These employees are typically craft and service workers, their first line supervisors, and in some cases, the second level middle management.

Q2

BARRINGTON-WELLESLEY GROUP, INC.

CASE NOS. 2003-00334 & 2003-00335

Response to First Data Request of Commission Staff
Dated October 6, 2003

Question No. 2

Responding Witness: David P. Vondle

Q-2. Refer to the BWG Report, page III-7, the discussion concerning income tax liabilities.

a. Indicate how many years of income tax calculations were reviewed by BWG and state how the number of years to be reviewed was determined.

b. For each year the income tax liability calculations were reviewed, provide the calculated tax liabilities collected from LG&E and KU and the corresponding consolidated tax liability for LG&E Energy Corp. ("LEC") and its parent.

A-2.

a. BWG DR 5-82 requested information for the years 1999 – 2002. Four years were selected obtain one year prior to ESM and the Powergen/E.On mergers.

b. The following information was provided by the Company in response to DR 5-82.

INTER-COMPANY CASH FLOWS

Federal Income Tax Payments	**1999**	**2000**	**2001**	**2002**
From LG&E to LEC	64.8	39.9	26.1	37.4
From KU to LEC	49.2	42.2	60.1	40.8
Total from Utilities	114.0	82.1	86.2	78.2
From LEC to: Powergen US or E.ON US US Treasury	 n/a [a]	 0.0 14.3	 0.0[d] 9.0	 22.7[d] [b,c]
From Powergen US or E.ON US to the US Treasury	n/a	0.0	0.0	0.0

Footnote(s):

a. Payments of $12.2 mm were made to the U.S. Treasury in 1999 by KU. KU was given credit for the payments in the 1999 consolidated return tax settlement.
b. No payments were made to the Internal Revenue Service during 2002.

c. A refund to $10.0 mm was received during 2002. LG&E Energy had previously been charged for this overpayment in the tax settlement process.

d. Prior to the approval of the July 1, 2002, tax allocation agreement, LG&E Energy received tax settlements on behalf of Powergen US Investments Corp. of $54.8 mm and $27.1 mm during 2001 and 2002, respectively.

Q3

BARRINGTON-WELLESLEY GROUP, INC.

CASE NOS. 2003-00334 & 2003-00335

Response to First Data Request of Commission Staff
Dated October 6, 2003

Question No. 3

Responding Witness: David P. Vondle

Q-3. Refer to the BWG Report, page III-10, Recommendation No. 1. Explain in detail how naming a single executive as responsible for the integrity of the Kentucky regulated utilities would address the problem identified by BWG, when it is likely the employees below and the management above this individual would have both regulated and non-regulated responsibilities.

A-3. Our recommendation is that the employees below the utility executive would be exclusively devoted to utility operations. The utility executive would report to the LEC CEO, who would be also be responsible for LEC's unregulated operations, but they would be organized separately and independently of the utility operations. The utility executive would be responsible for assuring that Service Company charges to the utilities are fair and accurate and that payments and cash transfers to the parent and affiliates are proper.

Q4

BARRINGTON-WELLESLEY GROUP, INC.

CASE NOS. 2003-00334 & 2003-00335

Response to First Data Request of Commission Staff
Dated October 6, 2003

Question No. 4

Responding Witness: David P. Vondle and Joel F. Jeanson

Q-4. Refer to the BWG Report, page IV-5. The BWG Report states that the incentive payments in 2002 were at 100 percent or more and that the Short-Term and TIA payouts would have been lower without the merger-guaranteed floor. Indicate what the incentive payouts for the Short-Term and TIA would have been without the merger-guaranteed floor.

A-4. Page IV-5 of the report states that "in general, the Short-Term plan payouts in 2002 based on actual results were higher than the guaranteed floor," not the opposite as suggested above. For two participants in the Short-Term plan, cash payouts were based on the guarantee and were higher than what would have been paid out based on actual performance by $3,900.

The supplemental response to BWG DR 5-81 indicated that for 2002 the total TIA paid per the guarantee was $14.2 million, compared to the total TIA that would have been paid based on actual results of $13.4 million, for a difference of $0.8 million.

Q5

BARRINGTON-WELLESLEY GROUP, INC.

CASE NOS. 2003-00334 & 2003-00335

Response to First Data Request of Commission Staff
Dated October 6, 2003

Question No. 5

Responding Witness: David P. Vondle and Michael A. Laros

Q-5. Refer to the BWG Report, page IV-6, Recommendation No. 1. BWG has recommended that the incentive payments should be reduced if the allowed rate of return is not achieved.

a. In stating that a reduction should occur if the allowed rate of return is not achieved, does BWG mean the 11.5 percent rate of return on equity or anywhere within the deadband? Explain the response.

b. Based on BWG's experience, is this the normal "penalty" assessed for failing to meet target performance? Explain the response.

A-5.

a. For the ESM component of the incentive compensation program, the 100 percent incentive payment level should be set at the allowed rate of return, with lesser payments for results below the allowed rate of return but still in the deadband, and higher payments for returns above the allowed rate of return. This would align the incentive payments with the ESM and ratepayer interests.

b. The recommendation addresses an incentive program, not a "penalty" program. Incentive payments are earned for achieving targeted results. These payments are in addition to base compensation. The concept for incentive programs is to provide a "carrot" rather than a "stick."

It is normal for incentive compensation programs to require achievement of specific performance targets to earn incentive payments.

Q6

BARRINGTON-WELLESLEY GROUP, INC.

CASE NOS. 2003-00334 & 2003-00335

Response to First Data Request of Commission Staff
Dated October 6, 2003

Question No. 6

Responding Witness: Charles R. Parmelee

Q-6. Refer to the BWG Report, page V-8, Recommendation No. 1. Explain in detail how the implementation of a multi-year Earnings Sharing Mechanism ("ESM") based on the current ESM format would resolve the concern that the utilities may be encouraged to shift costs between accounting periods in order to invoke an ESM factor revenue adjustment.

A-6. BWG has not developed in detail a working model of a multi-year ESM. This was not within the scope of the project. The theory of the multi-year model vs. the one-year model is that it is much more difficult to shift costs in and out of a three year period and achieve the desired results (i.e., from the shareholders perspective, minimize refunds and maximize recoveries).

BARRINGTON-WELLESLEY GROUP, INC.

CASE NOS. 2003-00334 & 2003-00335

Response to First Data Request of Commission Staff
Dated October 6, 2003

Question No. 7

Responding Witness: Michael A. Laros

Q-7. Refer to the BWG Report, page VIII-3. BWG states, "The primary influence on cost structure has been implementation of the Value Delivery Team initiative, approved by the Commission in 2000." Provide citations to and quotations from the applicable Orders where the Commission approved the Value Delivery Team initiative in 2000.

A-7. BWG was referring to the Order approving the PowerGen acquisition of LG&E Energy (Order 2000-00095) that included comments regarding implementation of "world class best practices" through the merger. Although not specifically referencing the Value Delivery Team program, the VDT was the subject of Walsh and Gallagher presentations on how the merged companies would achieve world class best practices. As shown in response to BWG Data Request 1-10, VDT status reports are provided by the Company to the Commission in compliance with the requirement included in the Summary of Findings for this Order, Item 12, to file semi-annual reports detailing the adoption and implementation of best practices at LG&E and KU. BWG is not aware of any Order specifically approving the Value Delivery Team initiative.